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IN THE

Supreme Court of the United States

OCTOBER TERM, 1920.

No. 125.

VANDALIA RAILROAD COMPANY,
Plaintiff in Error.

vs.

GUSTAV A. SCHNULL, WILLIAM J. GRIFFIN AND GEORGE G. GRIFFIN, COMPOSING THE FIRM OF SCHNULL & CO., ET AL.,
Defendants in Error.

BRIEF OF DEFENDANTS IN ERROR

CHARLES W. SMITH,
HENRY H. HORNBROOK,
Attorneys of Record for Defendants in Error.

CHARLES REMSTER,
ALBERT P. SMITH,
PAUL Y. DAVIS,
Of Counsel.

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STATEMENT OF THE CASE.

The statement of the case in the brief of counsel for plaintiff in error correctly states the nature of the suit and that part of the pleadings and rulings by which counsel sought to raise in the state court the federal question upon which they rely. After this statement of the record counsel continue:

"The question involved is this: If the rates fixed by the order of the commission in question will not produce revenue sufficient to reimburse the carrier for the actual cost and outlay in handling and carrying the classes of property specified in the order and provide a fair return to the carrier on the value of its property used and employed in performing the service, is the order constitutional and valid." (Brief of plaintiff in error, pages 3-4.)

As will hereafter develop in our argument, we do not believe that the averments of the second paragraph of answer are sufficient to present the issue of law outlined in the above quotation from the brief of plaintiff in error. It might, nevertheless, be contended that the question thus stated is raised by the evidence. Upon this point the State Supreme Court said (Transcript of Record, p. 107):

> "The cause was tried, and appellant's (plaintiff's-in-error) evidence tends to prove the substance of the answer (second paragraph) as above quoted, and no complaint is made of the exclusion of any offered evidence.
>
> "Whether, therefore, our ruling be based on appellant's construction of its answer or upon the evidence heard, we are satisfied that the defendant has not tendered or made a defense."

We would, therefore, respectfully invite attention to the fact that the only evidence offered by plaintiff in error was a copy of a petition before the Public Service Commission for a suspension of the order in question, and the order denying same, and that plaintiff in error offered no evidence bearing upon the reasonableness of the rate in question. (Transcript of Record, pp. 94-98.)

The statement which we have quoted from the opinion of the trial court is, therefore, entirely without support in the evidence, and unless the averments of the answer are sufficient to raise the question which counsel contend is involved, it is not raised.

BRIEF OF THE ARGUMENT.

The argument of counsel for plaintiff in error is entirely confined to the question outlined on pages 3-4 of their brief. Before proceeding to a discussion of that question we desire to urge upon the court that the issue thus outlined is not raised by the record herein. The only federal question sought to be raised by plaintiff in error arises on the demurrer to the second paragraph of answer, which reads as follows:

> "For a further and second paragraph of answer to plaintiff's complaint, Vandalia Railroad Company, defendant herein, says:
>
> "That the rates specified in the order mentioned in said complaint and which was made and entered by the Railroad Commission of Indiana on the fourteenth (14th) day of December, 1906, and which by its terms was to become effective on the first (1st) day of February, 1907, will not yield to defendant revenue sufficient to reimburse defendant for its actual cost and outlay in handling and carrying the classes of property specified in said order of said Railroad Commission, and provide a fair return to defendant on the value of defendant's property used and employed in handling and carrying the classes of property in said order specified.
>
> "And defendant further says that under Section 1 of Article 14 of the Constitution of the United States, defendant cannot be lawfully deprived of its

property without due process of law, nor be deprived of the equal protection of the laws; and that if the rates specified in said order of the Railroad Commission of Indiana be enforced defendant will be compelled to handle and carry said classes of property in said order specified without deriving or receiving therefrom revenue sufficient to pay the actual cost to defendant of handling and carrying said classes of property and provide a fair return to defendant on the value of defendant's property used and employed in handling and carrying said classes of property, and defendant will thereby be deprived of its property without due process of law in violation and contravention of said Section 1 of Article 14 of the Constitution of the United States.

"Wherefore, defendant says that the rates specified in said order, of said Railroad Commission of Indiana, and likewise said order, are illegal and void, and prays to be hence dismissed and that it have judgment herein against plaintiffs for all its costs and charges herein laid out and expended."

It will be noted that this *does not allege* that the rates in question will not yield "revenue sufficient to reimburse defendant for its actual cost and outlay in handling and carrying the classes of property specified in said order," *between the stations to which the rate applies*, "and provide a fair return to defendant on the value of defendant's property used and employed in handling and carrying the classes of property in said order specified," *between the stations to which the rate applies.*

On the contrary, the answer fails entirely to specify any particular carriage, which, when performed for the rates in question, will be non-remunerative. Consistently with the allegations of the answer, it might well be that the rates in question would be remunerative for "handling

and carrying the classes of property specified in said order" *between the stations to which the rates apply*, and would only be non-remunerative when applied to some other carriage.

Likewise, the answer fails entirely to specify upon what part of the carrier's "property used in handling and carrying the classes of property in said order specified" the rates in question will not yield a 'fair return'. Consistent with the allegations of the answer, the rates in question might yield a fair return on the value of the carrier's property *used in carriage between the stations named in the order*, although not sufficient to "provide a fair return on the value of * * * property used and employed in handling and carrying the classes of property in said order specified" *over some other part of its line.*

Accordingly, to admit by demurrer the truth of the answer is not to admit that the rates in question will not yield sufficient revenue to reimburse the carrier for its actual cost and outlay in handling and carrying the named classes of property between the points named in the complaint, and to provide a fair return on the value of the carriers property used in the carriage of such classes of property between such points. The demurrer simply admits that the rates in question will not yield sufficient revenue to reimburse defendant for its actual cost and outlay in handling and carrying the named classes of property *in all instances* in which it is compelled to handle such classes of property, not merely in the carriage to which the rates apply; and provide a fair return to defendant on the value of all the property used by it *everywhere*, not alone in carriage between the stations named, in handling and carrying the such classes of property.

The allegation "that the rates specified in the order * * * will not yield to defendant revenue sufficient to reimburse defendant for its actual cost and outlay in handling and carrying the classes of property specified in said order * * *," is susceptible of two constructions, viz:

(1) It may mean that the return from the carriage of the named classes of property between the named stations, will not yield sufficient revenue to reimburse the carrier for the cost of handling such property both between the named stations and in all other instances; or

(2) It may mean that the return which would be derived from carrying such classes of property at such rates, in all instances in which the carrier is compelled to carry such property, would not be sufficient to reimburse the carrier for its cost and outlay in all such instances; or more briefly, that if similar rates were applied to all its carriages of all such property, its return would not be sufficient to reimburse it for the cost of all such carriage.

Upon either construction the answer fails to allege sufficient facts to show that the rates are constitutionally unremunerative. As to the first construction, it is obvious that a comparison of the return from the carriage of the named classes of property, between the stations named, with the cost of carriage of such property both there and elsewhere is wholly immaterial in determining the reasonableness of the rates. The only relevant item of cost is the cost of the particular carriage to which the rates apply. As to the second construction, it has been expressly held by this court that in attacking the reasonableness of a particular rate, it is not sufficient to show that such rate,

applied generally, would be unremunerative. *Minneapolis & St. Louis R. R. v. Minnesota*, 186 U. S. 257.

But regardless of which construction is adopted for the portion of the answer last quoted, the remainder of the answer contains a defect which vitiates the whole. To allege that the rates will not "provide a fair return on the value of defendant's property used and employed in handling and carrying the classes of property in said order specified" is by no means to allege that the carrier will not receive a fair return on the value of its property used in the particular carriage to which the rates apply. The value of the carrier's property elsewhere used in carriage of these classes of freight is an element entirely foreign to the issue which the answer attempts to tender; since there is no allegations as to the revenue which actually is received from such other carriage. Whatever the return to which defendant may be entitled on the value of its property used in the carriage of the named classes of freight *between the stations to which the rates apply*, it is obviously not entitled to a return from such carriage on the value of its property *used elsewhere, between other stations, or on other lines or divisions*, in the carriage of such classes of freight. Yet the property mentioned is property used "in handling and carrying the classes of property specified" and is not limited to property used for such carriage between the named stations.

However, even if it be assumed that it sufficiently appears that the rates specified in the order are not sufficient to pay the cost of the particular service to be rendered for those rates and in addition a 'fair return' on the value of that part of the carrier's property used in performing that

service, we submit that the plaintiff in error has failed to show that the rates are unconstitutionally non-remunerative.

Counsel rely entirely on *Northern Pacific Ry. Co. v. North Dakota*, 236 U. S. 585, and *Norfolk and Western Ry. v. West Virginia*, 236 U. S. 605. In the first of these cases, a statutory freight rate on coal, applying to all intrastate traffic within the State of North Dakota, was held unconstitutional upon a showing that after paying all costs and expenses, including both 'out of pocket' costs attributable to the particular traffic and a more or less arbitrarily apportioned share of total operating expenses, the net proceeds would be merely nominal, affording no substantial contribution to the total net return on the carrier's investment. The West Virginia case exhibits analogous circumstances in connection with a passenger rate applying to the entire state.

These cases are clearly distinguishable from the situation presented by the allegations of the answer. In the first place, the answer does not allege that the revenue to be yielded by the rates will be insufficient to reimburse defendant for its cost and outlay on the traffic; but alleges that such revenue will not be sufficient to cover such "cost and outlay" *and* a "fair return" on the property used in the service. Consequently, it must be assumed that there is some surplus or net revenue above such "cost and outlay". The statement, that "since the carrier is entitled to receive a fair return upon the value of all its property used for the benefit of the public to hold that the carrier may be required to carry a part of its traffic at a loss would mean that the loss must be made good by rates imposed

upon other parts of its traffic," on page 8 of the brief, is not germane to the issues because the answer shows no loss.

The answer merely states that such surplus or net revenue is insufficient to "provide a fair return to defendant (plaintiff in error) on the value of defendant's property employed." It does not otherwise indicate what the size of that surplus is. It is not alleged that such surplus is insufficient to pay that proportion of a reasonable return on the value of the carrier's property used therein with the earning of which this particular traffic is reasonably chargeable. For all that appears in the answer, this surplus may be much more than sufficient to provide for plaintiff in error that portion of the fair return on the value of its property which this particular traffic could reasonably be expected to pay.

Conceding for the sake of argument only, that the decisions in the two cases last cited go to the full extent of requiring that the net proceeds from every service performed, no matter how small the item, shall be sufficient to yield a *fair proportion* of a reasonable return on the entire investment; a proposition which we believe is far beyond either the decision or the reasoning of those cases; nevertheless, no court has ever decided, and we believe that no one has ever contended, that the net return realized by a carrier from any particular class of traffic or service should, in and of itself, be sufficient to pay a fair return on the value of the entire property employed in the service. Merely to state such a proposition would be to refute it.

The entire, or at any rate a very large part of the invested capital of every carrier is employed by it indiscrim-

inately in hauling many different classes of freight and performing many different services, for each of which it receives different rates, and each of which yields a different net return.

If the carrier were allowed to derive from each of these separate items or classes, a fair return on the value of property employed in performing that and other services, it would result that the sum of the net returns from all classes of service rendered by a carrier would be many times the amount of a reasonable return on its invested capital. Such a result is absurd.

In both the North Dakota and West Virginia cases it appeared that the net return on the traffic in question was so small as to be merely nominal, and thus that its contribution to the entire net revenue was entirely disproportionate to the volume of the traffic. It was said in the latter case:

> "It is clear that by the reduction in rates, the company is forced to carry passengers, if not at or below cost, with merely a nominal reward considering the volume of the traffic affected."

In the present case it merely appears that the revenue from these rates will not, alone, be sufficient to pay a fair return on the value of the property employed, but it does not appear, either that this traffic will not produce a net revenue; or that the revenue from this and other traffic in which the same property is employed will be insufficient to pay such fair return on that investment; or that the net return from this traffic will be disproportionately small.

Consequently, although the North Dakota and West Virginia cases be given their broadest application in favor

of plaintiff in error, the rule announced will not establish the sufficiency of the answer.

In both North Dakota and West Virginia cases there were certain controlling factors which do not here appear. In both cases the rates in question were applicable to the entire intrastate traffic in a particular commodity or class of service. Here it appears from the complaint and also from the evidence that the line of railroad to which the rates applied is only one "among others" which plaintiff in error operates in the State of Indiana. In both of the cases cited it also appeared that any return, over and above the "cost and outlay", was merely nominal and afforded an entirely negligible contribution to the net earnings of the carriers. Here, even though it be assumed that the return is not fairly proportionate to the volume of the traffic, there is no allegation from which it can be assumed that the contribution to the railroads net revenue is so merely nominal that it can be disregarded, or that, although it may not bear that mathematical proportion to the entire net earnings which it should bear according to good business practice, it does not afford a substantial increase in net revenues which would not otherwise accrue if the traffic were compelled to bear a heavier rate burden.

Considering the second of these distinctions, it may be admitted that the North Dakota and West Virginia cases have greatly discredited the previous theory and practice under which a rate which returned any revenue over and above "out of pocket" costs was considered to be constitutionality remunerative, even though it did not even return that portion of the "overhead" or operating expenses incurred generally for all traffic which by good accounting practice was reasonably attributable to it; provided the

entire net revenue afforded reasonable return on the entire investment. It is perhaps true also that the opinions in these cases require that a rate applying generally throughout a state shall afford revenue not only sufficient to repay the "out of pocket" expense and its proper proportion of the "overhead" or operating attributable to all traffic, but shall also afford a substantial net return in addition. This is not to say, however, that this net return derived from each class of traffic must be a "fair return." The carrier is, of course, entitled to a "fair return", that is, reasonable interest, on its entire investment, from its entire business. What is meant by a "fair return" from a part of this business is entirely problematical. Construed most favorably to plaintiff in error, this allegation of the answer means such a return as would be chargeable against it by good accounting practice, in order that each item of business might "fairly" bear its share. Even when the words are thus favorably construed, to allege that certain rates do not produce a "fair return" on investment over and above "cost and outlay" is by no means to allege that the return produced is so nominal as not to be a substantial contribution to the carrier's net revenue. And as said in the North Dakota case, "the legislature, undoubtedly, has a wide range of discretion in the exercise of the power to prescribe reasonable charges, and it is not bound to fix uniform rates for all commodities or to secure the same percentage of profit on every sort of business." (Pp. 598-599.)

The other important distinction between the cases cited and this case is that the former dealt with the carrier's entire intrastate traffic in a certain commodity or classification of freight. Here the rates in question deal with

only a part of the carrier's lines. If the contention of plaintiff in error be sustained, it would follow that the rate on any particular article or class of freight between any two stations could be shown to be unreasonable by showing, by accounting methods necessarily more or less arbitrary, that after deducting the "out of pocket" cost and proportion of overhead attributable, such rate would not provide a net return entirely commensurate with the relation of the traffic in question to the total traffic; and this without regard to the return received by the carrier from its other intrastate business.

In the cases cited the court was very careful to guard its opinion from such a construction. In *Northern Pacific Ry. Co. v. North Dakota*, 236 U. S. 585, 599, the court said:

> "Nor is its (the state's) authority hampered by the necessity of establishing such minute distinctions that the effective exercise of the rate making power becomes impossible. It is not bound to prescribe separate rates for every individual service performed, but it may group services by fixing rates for classes of traffic."

And again:

> "The court, therefore, is not called upon to concern itself with mere details of a schedule; or to review a particular tariff or schedule which yields substantial compensation for the services it embraces, when the profitableness of the intrastate business as a whole is not involved."

Indeed, the court was careful to distinguish, and not to overrule, previous decisions sustaining rates or regulations under circumstances almost exactly parallel with

those here exhibited. Thus in *St. Louis & San Francisco Ry. v. Gill*, 156 U. S. 649, a carrier defended an action for a penalty for its failure on one division to observe a statutory passenger rate of state wide application, by showing that on this division the rate resulted in loss. This was held to be no defense, the court saying, p. 655:

> "In this state of facts we agree with the views of the Supreme Court of Arkansas, as disclosed in the opinion contained in the record, and which were to the effect that the correct test was as to the effect of the act on the defendant's entire line * * *; that the company cannot claim the right to earn a net profit from every mile, section, or other part into which the road may be divided, nor attack as unjust a regulation which fixed a rate at which some such part would be unremunerative."

The North Dakota case not only does not overrule this decision, but quotes with approval from that part of the opinion above set forth.

In the present case the facts alleged are even less favorable to the carrier, since it does not appear even that the entire freight business on this one division will not yield its proportionate share of the net revenue to which the carrier is entitled, but only that the business of carrying the named classes of property on this division will not yield a "fair return"; and for all that appears the revenue derived from other traffic on this division and from the traffic on other divisons under rates fixed by the State Commission will yield a fair return on the value of the carrier's property employed, and the rates in question a substantial contribution to that return.

Other decisions which support the principle involved in the ruling of the State Supreme Court, and which re-

main unshaken by the North Dakota and West Virginia cases are *Minneapolis & St. Louis R. R. Co. v. Minnesota*, 186 U. S. 257, and *Willcox v. Consolidated Gas Co.*, 212 U. S. 19.

The rates fixed by the state, either by the legislature directly, or through its "administrative agent", the commission, for the lines of the plaintiff in error in Indiana, form one entire scheme; though the legislative will be expressed in various separate orders. Whatever may be the proper construction of the answer, it is undoubtedly an attempt to segregate a particular traffic, on a particular division, and without alleging that the rates in question compel service below cost, and without alleging that the net return is so small as to be unsubstantial, to attack their unconstitutionality on the ground that the net return is, in some indefinite sense, "unfair". To permit the carrier to attack each separate order by showing that the rates therein prescribed do not yield a "fair return", is as much out of harmony with any decided cases as would be a similar attack on any particular part of any separate order. We submit that the state rate making power is not thus narrowly confined, and that the judgment should therefore be affirmed.

Respectfully submitted,

CHARLES W. SMITH,
HENRY H. HORNBROOK,
Attorneys of Record for Defendants in Error.

CHARLES REMSTER,
ALBERT P. SMITH,
PAUL Y. DAVIS,
Of Counsel.